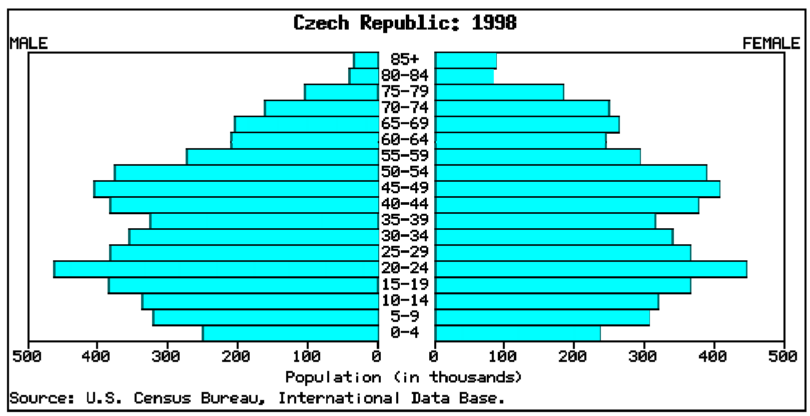
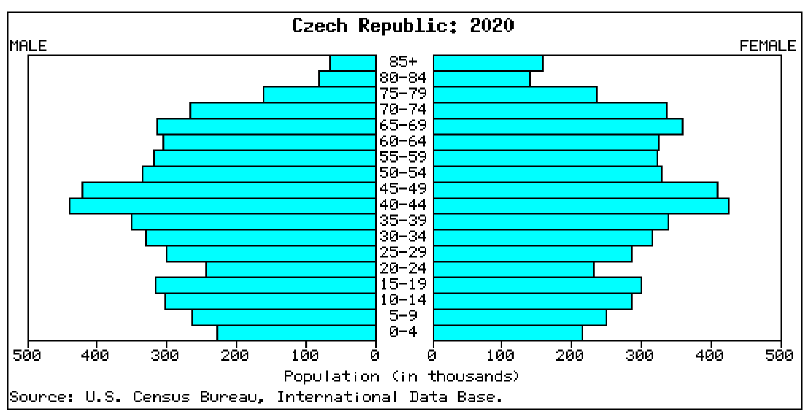
Czech Republic

Summary of Current System			
	Pillar 1	**Pillar 2**	**Pillar 3**
Type:	♦ Defined-benefit		♦ Defined-contribution
Participation:	♦ Mandatory		♦ Voluntary
Management:	♦ Publicly-managed		♦ Privately-managed
Financing:	♦ PAYGO		♦ Fully funded
Coverage:	♦ All economically active individuals		♦ All individuals over 18 years and residents of the Czech Republic
Eligibility:	♦ Age 62 (men) or age 58-61 (women), and fulfilled minimum contribution requirements		♦ At the earliest from age 50, or in the event of death or disability

Challenges Facing Pension System

- ❑ Demographic shifts
- ❑ Financial burden of benefit provision
- ❑ Contribution evasion





Summary of Current Pension System

The Czech pension system consists of two pillars: a mandatory, public system (or Pillar I) and voluntary, privately-managed pension accounts (or Pillar III). Incremental reforms to the public pillar were introduced in 1996, which included increases in the retirement age and more stringent eligibility requirements.

The public pension system provides old-age, disability and survivor pensions for all individuals in the work force. This defined-benefit scheme is financed on a pay-as-you-go (PAYGO) basis. Individuals are entitled to full retirement benefits when they have reached a minimum retirement age and have met the minimum contribution period.

The retirement age for men was increased to 62 years (up from 60 years) in increments of two months annually. The retirement age was also increased for women in increments of four months annually. Women may retire between age 58 and 61, depending on the number of children reared. Increases in the retirement age will have taken effect by 2007. Eligibility for pension benefits occurs only after an individual has completed 25 years of contributions. Early retirement is available within two years of the normal retirement age, if 25 years of contributions have been made. Individuals who have reached 65 years and have contributed for at least 15 years are entitled to proportionately reduced pension benefits.

The pension system is primarily financed by a 26 percent payroll tax (6.5 percent of employee earnings and 19.5 percent of employer payroll). The government provides additional funds if the pension system incurs any deficits. Pension benefits consist of a basic fixed amount and an earnings-related amount. This earning-related amount is based on 1.5 percent of average indexed earnings (over the past 30 years) for each year of contribution. Pension reform also focused on developing an automatic link between benefits and the growth of wages and prices. Thus, pension benefits are adjusted by

Czech Republic

SELECTED INDICATORS		
	Year	
Demographic	*1998*	*2020*
Total Population (in thousands)	10,287	10,309
Life Expectancy at Birth (Years)	74.11	78.51
Total Fertility Rate (Child Born per Woman)	1.17	1.54
Age Dependency Ratio (percent)	28.1	45.7
	1980-2000	*2000-2020*
Average Annual Rate of Population Growth (percent)	0.0	0.0

Source: U.S. Bureau of the Census. International Data Base.

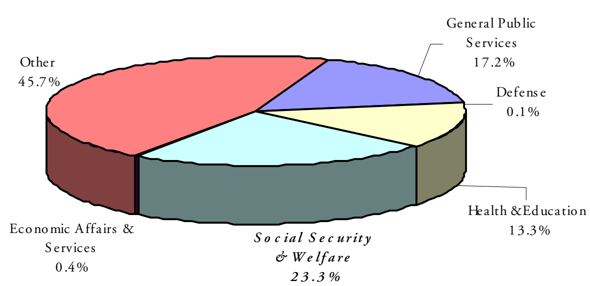
Economic	*1996*
GNP (PPP in billions)[1]	112.1
GNP Average Annual Growth Rate, 1995-1996 (percent)[1]	4.4
GNP Per Capita (in PPP)[1]	10,870
Inflation Rate (percent)[2]	8.8
Labor Force Participation Rate (percent)[3]	55.4
Unemployment Rate (percent)[3]	3.9

Source: [1]World Bank; [2]IMF; [3]International Labour Office.

Pension	*1997*
System Dependency Ratio, 1995 (percent)[1]	61.0
Employee Contributions for Pensions (percent of earnings)[2]	6.5
Employer Contributions for Pensions (percent of payroll)[2]	19.5
Public Pension Expenditure as % of Government Expenditure[3]	n/a
Public Pension Expenditure as % of GDP, 1996[1]	8.4

Source: [1]IMF; [2]U.S. Social Security Administration; [3]de Castello Branco (1998).

GOVERNMENT SPENDING BY SECTOR, 1996



Source: International Monetary Fund. Government Finance Statistics Yearbook, 1997.

one-third of the average increase in wages during the previous two years, and when price inflation exceed five percent from the previous adjustment.

The passage of the State Contributory Supplementary Pension Insurance Act of 1994 allowed the development of supplementary pensions that included contributions from the state. Pension plans are defined-contribution schemes, and benefits may be paid when the individual reaches 50 years old. Pension funds are typically joint-stock companies, which manage the contributions from individuals and the state. Currently, there are approximately 44 authorized pension funds available in the Czech Republic. An estimated 1.6 million employees were contributing to pension funds generating assets totaling 0.8 percent of GNP in 1997. Employees are prohibited from contributing to more than one pension fund simultaneously. They are, however, permitted to change funds and transfer accrued benefits at any time.

Challenges Facing Pension System

Financial projections, prepared by the Czech authorities, indicate that if the current replacement rate is maintained and the retirement age increases as legislated, mandatory contributions to the pension fund must increase from 26 percent to 36 percent to ensure fund solvency. Furthermore, if the current contribution proportions were maintained, pension expenditures would exceed revenues beginning in 2005. Initial recommendations to ensure the financial viability of the pension fund include increasing contributions to 29 percent and injecting CZK 40 billion in capital contributions.

As with other countries operating PAYGO systems, the Czech pension system solvency is susceptible changes in the demographic profile of the population. Currently over one-quarter of the Czech population is at least 60 years old, and this proportion will rise to 46 percent by 2020. In addition, participation in the informal economy shrinks the pension fund's revenue base. Government officials have estimated that the level of participation in the informal economy is about 10 percent of GDP. The economy also impacts the performance of the pension fund. Although the economy was experiencing a five-percent rate of growth, other economic indicators (i.e., the trade deficit) were not as positive.

Pension Reform Efforts

Legislation is under consideration to improve the regulatory structure of voluntary pension funds (although parliament has not yet approved the measure). In an effort to protect private pension fund investments, the Czech government submitted a draft amendment in February 1998 to increase government supervisory control of these pension funds. The draft amendment included requirements increasing the minimum capital level needed to establish a pension fund and increased regulation of foreign investments and portfolio management. While there are no current efforts to introduce fundamental reform to the pension system, the Czech government may consider moving to a fully-funded pension system.

Pension Reform Efforts by Pillar

	Pillar 1	Pillar 2	Pillar 3
Papers issued on state of pension systems	✓		✓
Formulation of proposals	✓		✓
Development of draft legislation	✓		✓
Introduction of legislation by parliament	✓		✓
Review of legislation by parliament	✓		✓
Passage of legislation by parliament	✓		✓
Implementation of legislation	✓		✓